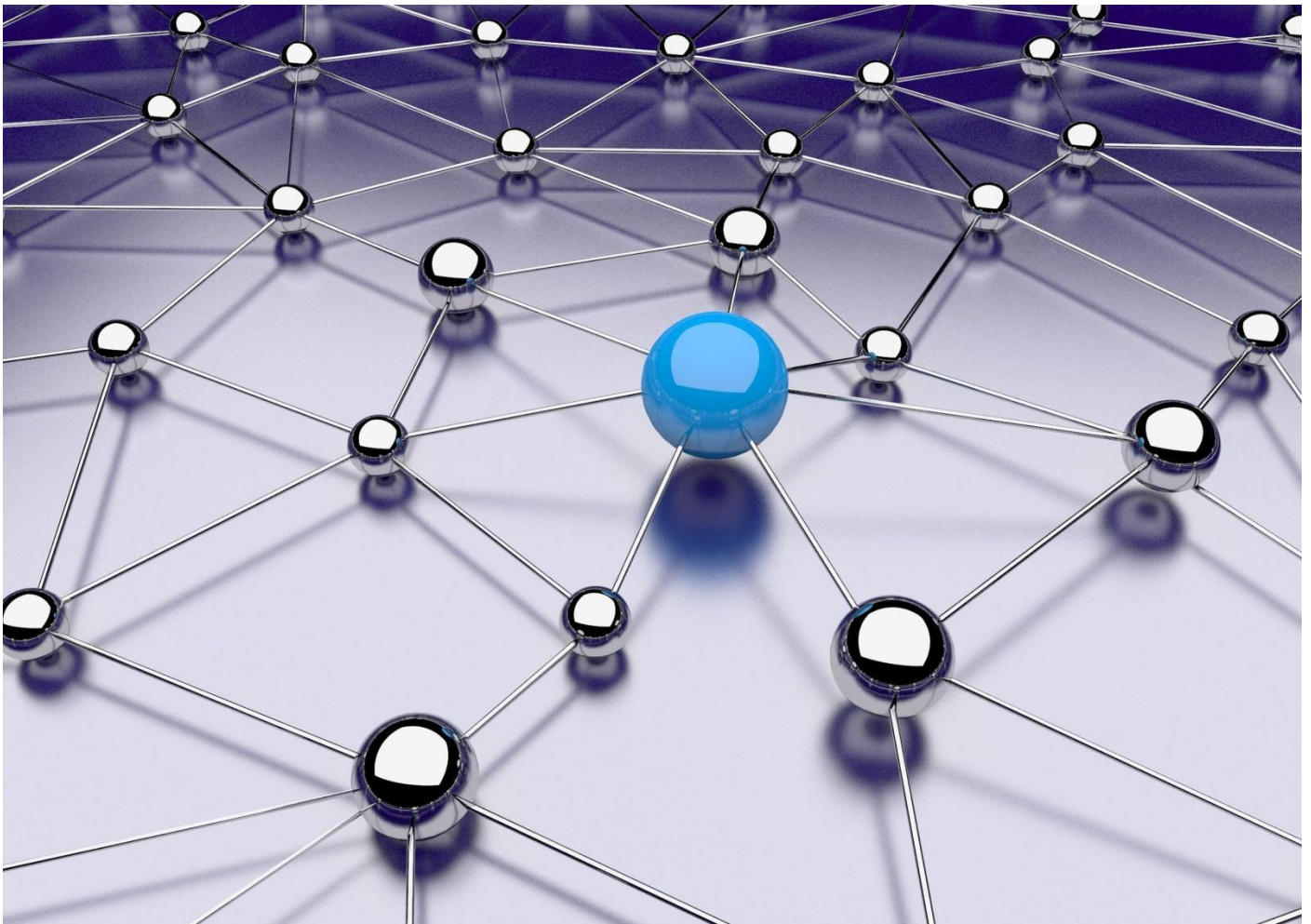


Annual Audit Letter 2015/16

City of York Council



October 2016

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27 October 2016

Dear Members

City of York Council - Annual Audit Letter 2016

I am pleased to present to you City of York Council's (the Council's) Annual Audit Letter. The purpose of this document is to summarise the outcome of our audit of the Council's 2015/16 annual accounts and our work on the value for money conclusion.

We carried out the audit in accordance with the Code of Audit Practice for Local Government bodies issued by the National Audit Office and delivered all expected outputs in line with the timetable established by the Accounts and Audit Regulations 2015.

We issued an unqualified opinion on the statement of accounts and an unqualified value for money conclusion.

I would like to express my thanks for the assistance of the Council's finance team, as well as senior officers and the Audit and Governance Committee.

If you would like to discuss any matters in more detail then please do not hesitate to contact me on 0191 383 6300.

Yours faithfully

Gareth Davies
Partner
Mazars LLP

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Our reports are prepared in the context of the 'Statement of responsibilities of auditors and audited bodies 2015-16' issued by Public Sector Audit Appointments Ltd. Reports and letters prepared by appointed auditors and addressed to Members or officers are prepared for the sole use of the Council and we take no responsibility to any Member or officer in their individual capacity or to any third party.

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01 Key messages

Our Annual Audit Letter provides a summary of our work and findings for the 2015/16 audit period for Members and other interested parties.

We reported the detailed findings from our audit work in our Audit Completion Report for City of York Council which was presented to the Audit and Governance Committee on 28 September 2016. The key conclusions for each element of our work are summarised below:

Our audit of the statement of accounts

We issued an audit report including an unqualified opinion on the Council's financial statements on 30 September 2016.

Our VFM conclusion

We carried out sufficient, relevant work, in line with the National Audit Office's guidance, so that we could conclude on whether you had in place, for 2015/16, proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

We issued an unqualified VFM conclusion on 30 September 2016.

Whole of Government Accounts

We provide assurance to the National Audit Office (NAO), as the auditor of central government departments, in relation to the consistency of your WGA consolidation pack with the audited statement of accounts. We reported that your consolidation pack was consistent with the audited statement of accounts on 20 October 2016.

Our other responsibilities

As the Council's appointed external auditor, we have other powers and responsibilities as set out in the Local Audit and Accountability Act 2014. These include responding to questions and objections on the accounts raised by local electors as well as a number of reporting powers such as reporting in the public interest.

Objection to the accounts

On 11 August 2016 we were notified by a local elector of an objection to the Council's accounts. The objection notice raised a number of issues, from which two specific areas relating to the procurement of services from two separate suppliers constituted a valid objection. At the time of writing, we are considering the Council's response to the issues raised in the objection.

The expenditure in the 2015/16 accounts relating to these procurements was below £100k and consequently well below the level of materiality for our opinion on the financial statements. We were able to issue our opinion and VFM conclusion on 30 September 2016, but we are unable to certify completion of the audit, and will be unable to do so until the objection has been determined.

Public interest report

Since our last Annual Audit Letter was published we have issued a Public Interest Report entitled *Governance Issues in relation to Remuneration of Council Officers for work as Directors of City of York Trading Ltd*. This related to the 2014/15 audit, was issued under the Audit Commission Act 1998 and was published on 26 February 2016.

The report identified:

- governance failings in relation to remuneration of Council officers for work as Directors of this Council-owned trading company;
- action needed to regularise the position; and
- important lessons to be learnt and applied to ensure the future good governance of the Council's relationships with its trading companies.

We made a number of important recommendations which were agreed by the Council.

During the 2015/16 audit, we followed up the progress made by the Council in addressing our recommendations and this is set out in section 4 of this report.

02 Financial statements

Audit of the financial statements

We audited your financial statements in line with auditing standards and we reported our detailed findings to the meeting of the Audit and Governance Committee on 28 September 2016. We issued an audit report, including an unqualified opinion, on the statement of accounts on 30 September 2016.

Risk and materiality

Our work on your financial statements aims to provide reasonable assurance that your accounts are free from material misstatement. The assessment of materiality is, therefore, a key part of our work and we specify an overall materiality threshold, based on your gross revenue expenditure, together with lower materiality values for accounting entries we consider to be more sensitive, such as officer remuneration and members' allowances.

We consider materiality when planning and performing our work and in assessing the results.

At the planning stage, we make a judgement about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures. We updated our materiality calculation when we received the draft accounts and set the overall level at £7.4m. We do not purely use a formula for our calculation of materiality and we look at any errors identified on their merits and can choose to report errors and uncertainties below our thresholds if we deem this to be appropriate.

In applying our view of materiality we identified the following two significant risks:

- management override of controls; and
- accounting entries for pensions.

We carried out a programme of work to address these risks which included the testing of journals, transactions and disclosures. Our work did not identify any issues to report.

In completing our work we assess the scale of errors and uncertainties using our materiality calculation to determine the impact on our audit reports. We did not identify any material errors in your statement of accounts.

Preparation of the accounts

During the course of the audit we did encounter one significant matter that required discussion with management, relating to the revaluation of Council dwellings.

In the draft accounts presented for audit, the value of Council dwellings increased by £43.9m, or 16.0%, between 1 April 2015 and 31 March 2016, against a gross book value of £276.1m. This followed a full revaluation carried out by the valuer at 1 April 2015; a full valuation is undertaken once every 5 years with a desktop revaluation exercise in the intervening years.

In view of the material nature of the increase in the valuation and the low likelihood that the increase related entirely to the past year, we discussed with officers whether a prior period adjustment should be made.

We accepted officers' view that it should not because (under IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors) the significant increase following the revaluation arose from a change in accounting estimate rather than a change in accounting policy or an error, and IAS 8 states that for a change in accounting estimate, in this case the value of council dwellings, this would be adjusted in the current year and not give rise to a prior period adjustment.

We have recommended that the Council reviews its approach to the revaluation of Council dwellings in the years when a full revaluation is not carried out. Officers have agreed to address this recommendation.

Follow up in relation to the bank reconciliation

We are pleased to report that our recommendation from last year to resolve historic discrepancies in the Council's bank reconciliation has been fully implemented and there are no outstanding issues relating to the bank reconciliation to bring to the attention of Members.

Preparation of the accounts

The Council presented us with draft accounts in accordance with the national deadline. Working papers and other supporting evidence were produced on a timely basis throughout the audit. Your arrangements and the responsiveness of officers enabled us to complete our comprehensive procedures efficiently.

Issues arising from the audit of the accounts

We would like to highlight the following key points:

- officers prepared good quality draft financial statements and working papers;
- there were few errors identified; and
- the audit progressed well and we received the full co-operation of officers.

Annual Governance Statement (AGS)

The AGS is drafted by the Council to provide assurance to the reader over how it is managed and how it has dealt with risks in the year. We reviewed the AGS to see whether it complied with relevant guidance and whether it was misleading or was inconsistent with what we know about the Council. We found no areas of concern to report.

03 VFM conclusion

For 2015/16, we were required to satisfy ourselves that the Council had made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We performed our work in this area in accordance with guidance set out by the National Audit Office. This required us to consider one overall criterion as set out below.

Overall criterion: *in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.*

Our work in this area focused on the three sub-criteria specified by the National Audit Office namely:

Sub-criteria	Focus of the sub-criteria
Informed decision-making	<ul style="list-style-type: none">• Acting in the public interest, through demonstrating and applying the principles and values of sound governance.• Understanding and using appropriate and reliable financial and performance information (including, where relevant, information from regulatory/monitoring bodies) to support informed decision making and performance management.• Reliable and timely financial reporting that supports the delivery of strategic priorities.• Managing risks effectively and maintaining a sound system of internal control.
Sustainable resource deployment	<ul style="list-style-type: none">• Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.• Managing and utilising assets effectively to support the delivery of strategic priorities.• Planning, organising and developing the workforce effectively to deliver strategic priorities.
Working with partners and other third parties	<ul style="list-style-type: none">• Working with third parties effectively to deliver strategic priorities.• Commissioning services effectively to support the delivery of strategic priorities.• Procuring supplies and services effectively to support the delivery of strategic priorities.

As part of our work, we also:

- reviewed your Annual Governance Statement;
- considered the work of other relevant regulatory bodies or inspectorates to the extent the results of the work have an impact on our responsibilities; and
- carried out risk-based work we determined to be appropriate.

Risk based work

We identified a significant audit risk around financial pressures from reduced funding and the continued need to identify plans to deliver future savings and improvements. Without robust budgetary control and delivery of its action plans, the Council's financial resilience and service performance could deteriorate.

In addition, there have been some high profile examples of problems with project delivery, such as the housing for older people procurement and more recently with the community stadium project. This has been the first year of operation of the Better Care Fund, which requires the Council to work with the local CCG and the wider health economy to reduce demand for acute healthcare. Any failures in these areas could compound the Council's financial and operational difficulties and impact adversely on services provided.

We reviewed budget monitoring and reporting, focusing on areas where action plans are in place to make savings and improvements, and seeking to minimise any adverse impact on service delivery. We reviewed the plans that are being developed to deliver savings and improvements.

We focused on:

- the budget process and the Medium-Term Financial Strategy;
- the progress made in identifying savings required;
- budget monitoring reports and other finance updates; and,
- delivery of improved outcomes.

In addition, we carried out a number of more detailed specific probes in areas of particular risk:

- overall programme and project management arrangements;
- the community stadium project;
- the older persons' accommodation programme;
- integration of health and social care and the operation of the Better Care Fund; and
- The 'future shape and size' programme, which considers the Council's future operating model and how services might be re-shaped to meet the challenges the Council faces.

These more detailed probes were carried out as additional fee work under the Code of Practice, and this work and the associated fee was approved by our regulator, Public Sector Audit Appointments Ltd.

We were able to gain sufficient assurance from our work to mitigate the audit risk although we note that the scale of the ongoing challenges facing the Council is significant.

Financial standing

Ongoing pressure on the public finances presents significant challenges for the Council and the need to plan for further reductions in spending power coupled with increased demand for services.

The Council has made good progress in addressing its biggest challenges to date and has a proven track record of strong budget management and delivering planned budget reductions.

The 2015/16 revenue budget included savings proposals to address reduced funding and cost pressures.

The Council achieved a better than expected outturn for both the General Fund and HRA in 2015/16.

2015/16	Original Budget	Funding	Net Budget position	Outturn Position	Comparison against Original Budget
General Fund - revenue expenditure	£119.8m	£119.8m	£0	£876k Surplus	£876k Improvement
Housing Revenue Account	£32.0m	£34.6m	£2.624m surplus	£4.344m Surplus	£1.720m Improvement

The main reasons for the better than expected General Fund Outturn included a £1.8m saving against central budgets, which was partly offset by a £968k overspend in directorate budgets. Central budgets benefitted mainly from reduced interest costs and increased interest income, arising from slippage in the capital programme. The biggest directorate overspend was in children’s services, education and skills (£791k). Adult social care, an area which has been subject to significant cost pressures in recent years achieved a net budget saving of £101k.

The Council has a significant capital programme, and the outturn for 2015/16 was £41.5m, compared to an original budget of £71.1m, the reduction mainly arising from slippage in the programme and re-profiling of budgets to future years.

Achievement of objectives

The Council Plan 2015 – 2019 sets out the Council’s corporate priorities.

Key Priorities

a prosperous city for all - where local businesses can thrive and residents have good quality jobs, housing and opportunities

a focus on frontline services - to ensure all residents, particularly the least advantaged, can access reliable services and community facilities

a council that listens to residents - to ensure it delivers the services they want and works in partnership with local communities

The Plan was approved by full Council in October 2015 and is a high level document that sets out key aims, improved outcomes and what the Council will do over the next 4 years.

In March 2016, the Council invited a Local Government Association (LGA) peer challenge review team to undertake follow up work on their previous Corporate Peer Challenge in June 2013. This identified a number of issues to address including the need for stronger and more visible leadership (political and managerial), improvement in the working relationship between officers and members, improved clarity of the Council’s vision and a budget process that better follows the Council’s stated priorities. The peer review also highlighted some areas that had improved and also concluded that service delivery had been good to date.

The Council has developed an action plan in response to the issues raised in the peer review.

Part of the response has included a revised performance management framework which aims to establish a 'line of sight' from the Council's vision and priorities, through key strategies, statutory plans and directorate plans and down to individual and team performance plans. As part of this initiative the Council has articulated a 'New Vision' for the City of York in 2030 which reflects the overall vision that *"the Council will secure the future of York as a prosperous, progressive, and sustainable city, giving the highest priority to the wellbeing of its residents, whilst protecting the fabric and culture of this world-famous historic city"*.

The Council's current performance reporting, including the Annual Report for 2015/16 published in June, includes a large amount of performance data and reporting on activities that have been undertaken, but lacks milestones that show how the Council will move from where it is now to where it aims to be.

The development of the new vision provides an opportunity for the Council to take stock on what it is seeking to achieve, clarify what needs to be done and then the steps that need to be taken over time. Through this process the Council needs to assess whether all of its current activities and projects are appropriately directed towards its key objectives and take corrective action where this is not the case.

Over the last year, the Council has experienced significant changes in senior management, and interim arrangements have been in place in some areas, including at Chief Executive level. A new permanent Chief Executive started on 1 August 2016 and a new management structure is being implemented.

Overall programme and project management arrangements

We found that the arrangements being put in place to improve programme and project management reflect good practice. We recognise that the new arrangements will take time to embed in the Council's wider management arrangements. It is important that the recommendations arising from the recent review by Veritau of programme and project management are fully implemented. We also see it as key that corporate oversight of programme and project management is maintained, and that adherence to the arrangements being put in place by the Programme Manager and other colleagues is supported and monitored by the Corporate Management Team. Reporting on programme and project management to the Audit and Governance Committee has noticeably improved as the Council has developed its new arrangements.

The community stadium project

The Community Stadium is one of the Council's most ambitious projects aiming to deliver a sustainable future for local football and rugby clubs whilst providing much wider economic and social benefits to the whole community through leisure, retail and health facilities on the site. The project has evolved over a significant period of time through:

- the initial concept for a new shared football and rugby stadium in 2009;
- a comprehensive business case in 2012 for the stadium combined with other sporting, health and educational facilities; and
- final plans for an extensive new stadium and leisure complex including significant retail development and a cinema.

The project has attracted considerable public interest and is highly complex in terms of the legal and contractual framework, planning requirements, procurement process, technical specification and costing as well as the management of the multiple stakeholders involved.

A key objective is to maximise private sector funding for the project with minimal Council contribution. The current plan shared with the Executive in March 2016 is for a £44.2m development with £14.4m of Council funding. In broad terms this represents £2 of private investment for every £1 of public funds. In this calculation, we have treated the £11.3m commercial land deal as private investment, although we recognise that this has been achieved in return for the Council giving up its land asset.

Following our preliminary review of the Council's arrangements for the delivery of this project as part of our Value for Money work in the 2014/15 audit, the project has progressed in many areas. Greenwich Leisure Ltd were approved as the preferred bidder for the design, build, operate and maintain contract in September 2014 and following detailed planning approval in March 2015, dialogue has continued to finalise the design specification including value engineering work to contain costs where feasible.

However, the project continues to experience significant delays due to the complexities of finalising the design, planning approvals and associated legal agreements. A necessary planning amendment was approved in June 2016. The latest anticipated timescale for the stadium to be operational is early 2018. Early works have been implemented to mitigate the impact of the delays.

The timescale slippage has had a consequent impact on costs due to inflation and contractors not being in a position to fix prices until financial close when agreements can be signed. Including project costs and contingency, the total cost of the development has risen to £44.2m as reported to the Executive in March 2016 against an original budget of £37m based on the final tender price submitted in May 2014, an increase of almost 19.5%.

The reasons for the capital cost increase reported in the paper are progression of the detailed design, construction inflation, delays in the timetable and the inclusion of an increased contingency. However, as reported at March 2016, the revenue consequences of the scheme show a favourable impact over the 13 years of the scheme. The projected net revenue cost of £1.3m over 13 years compares to a budget of £5.6m over the same period, a saving of £4.3m.

The current estimated final costs of the project and the costs that have been incurred to get the scheme to its current position have been the subject of public comment.

The Council has been unable to debate many of these issues in public whilst within a competitive dialogue procurement exercise and whilst involved in commercial negotiations with a range of parties to the project.

As part of our review we have had access to all information held in relation to this project, including commercially sensitive information. The view we have to form is not whether the project will succeed, but whether the Council has proper arrangements in place to manage this project and mitigate the risks of failure.

The Outline Business Case approved in March 2012 was of a high standard. The procurement process ran well with two bidders remaining at the final stage thereby providing a market benchmark for the final accepted tender price.

The most recent public report to Executive on the project in March 2016 set out recommendations to proceed with the Community Stadium and Leisure Facilities Project, agree the required project budget and agree to complete all final negotiations and legal agreements for the project to reach financial close.

Until financial close can be achieved, which is subject to constraints outside of the Council's control, contractor and sub-contractor agreements and leases cannot be signed. As is common for major construction projects of this nature, this means prices are not fixed and therefore cost variations have and will continue at least to reflect the impact of inflation over time.

The project team has implemented a detailed cost tracking approach to evidence scrutiny of cost revisions for both capital and revenue. Challenge of costs is provided by independent technical experts employed as part of the project team. This has happened from the commencement of the procurement process at each formal cost restatement stage including the accepted tender price and as the design was developed, through to the latest cost estimates. The Council has therefore tested on an ongoing basis whether the project represents value for money to the public at each stage and has continued to update that assessment over the project life cycle.

A further recent development is a judicial review claim lodged by Vue Cinemas against the June 2016 planning approval. The Council continues to assess the impact of this further delay.

Despite the significant complexities of this major project, we have observed good practice in many areas including disciplined governance and project management, a well-run procurement process, appropriate technical resourcing of the project team, detailed cost tracking and the use of specialist independent support when necessary.

Members of the Executive have received regular briefings on the project, and this continues to be the case.

In our view the public reporting to Executive could have been expanded without compromising commercial confidentiality. Officers' view is that they sought external legal advice on what to disclose and that the reports were at the limits of what it was possible to include in a public report.

We suggest that some limited additional narrative could have been used to provide more assurance to Members and the public, for example:

- the arrangements that had been put in place to scrutinise and challenge the costs through the cost tracking process, including the use of independent and specialist external advisors. The reports set out the costs but did not explain the controls which have been put in place by the project team to ensure value for money;
- summarising how the scope of the project had changed over time and the impact on costs. The cost increases are clear but the narrative explanation could have been expanded, setting out the key factors explaining the increases, e.g. the cost escalation due to inflation; and
- providing more information on the reasons for the delays and a revised project plan for the key workstreams.

We recommend that as the Council progresses the community stadium project, it:

- ensures there is at least quarterly reporting of the project to the Executive;
- continues to assess the balance between putting information in public papers, and the clear need to exercise commercial sensitivity at times;
- provides narrative explanation of its assurance arrangements, and how it has demonstrated that value for money has been achieved;
- clearly restates the costs and benefits of the project and further consideration of risks once financial close is reached and agreements are in place; and
- continues regular reporting to the Executive during the construction phase.

We conclude that the Council has proper arrangements in place for the ongoing management of the external challenges, risks and delivery of this complex scheme. The challenge now is to overcome the remaining planning obstacles, contain further cost pressures and achieve financial closure on the project so that the focus can move to the construction phase.

The older persons' accommodation programme

We followed up the actions taken since our review of the housing for older people's project which was reported to the Audit and Governance Committee on 29 July 2015. This review identified a number of areas for improvement following the abandonment of the older people's procurement early in 2015 on the grounds that the programme was not affordable.

Our report concluded that the older people's accommodation project was an ambitious and complex programme of work for the Council involving multiple inter-related work-streams, various stakeholder interests and a high public profile. This required a disciplined business case development, robust governance arrangements and tight programme management to provide assurance on risks and appropriate, timely communication to decision-makers and stakeholders. Although we identified some areas of good practice, there were some weaknesses in the Council's approach and arrangements in these areas and consequent opportunities for improvement and learning on future major projects.

Part of the Council's response was to strengthen its programme and project management methodologies which was considered earlier in this report.

In addition, in July 2015 the Executive approved the business case for a new older persons' accommodation programme. This programme has progressed well and in July 2016, there was a very comprehensive progress report to the Executive which recorded the tangible progress that had been made in a number of specific areas, future plans, and in particular placed this in the context of an analysis of demand, financial considerations, risk assessment, consultation and community engagement.

In our view, the work undertaken on the older persons' accommodation programme has comprehensively addressed the issues we raised, and arrangements are in place to deliver improved outcomes.

Integration of health and social care and the operation of the Better Care Fund

As experienced nationally, there have been significant challenges in progressing the integration of health and social care services. Some of these difficulties were evident in the operation of the first year of the Better Care Fund (BCF) in York.

The BCF is a national initiative which requires local authorities and Clinical Commissioning Groups (CCGs) to pool resources to realise the benefits of integrated care and support services. In the case of York, the pooled fund was £12.1m in 2015/16 with the majority of the funding provided by the Vale of York CCG.

The BCF objectives were summarised succinctly in reports to the Health and Well Being Board:

"In 2015/16 the main aim of the BCF was to reduce Non Elective Admissions to hospital, as well as having an impact on permanent admissions to residential care, improving the effectiveness of reablement and helping to reduce the number of Delayed Transfers of Care (DToc) across the system. A local aim to reduce the number of falls related injuries for the over 65s was also agreed. Partners across the health and social care system agreed these aims and our ambitious plan was finally fully signed off through the National Assurance Process in January 2016."

The Council and the CCG identified schemes that would support these objectives, however, it became clear that the measures taken were not delivering the level of improvement that had been hoped for on the measures included in the BCF plan for 2015/16.

The CCG experienced financial difficulties and in the Council's third quarter financial monitoring report for 2015/16, a potential financial pressure of £3m was reported due to issues with the Vale of York CCG, although it was hoped that this position would be resolved by the year end. The financial position was resolved for the Council and in terms of the adult social care budget a small underspend was achieved as noted earlier in this report.

There is an increasing imperative nationally and locally for more comprehensive and accelerated integration of health and social care, and an Integration and Transformation Board has been established as a sub board of the Health and Well Being Board to take this forward, including the development of a strategy for joint commissioning.

The 2016/17 BCF Plan, which is for £12.2m, has taken significant time to be agreed, due to ongoing negotiations between the Council and the CCG. We understand that NHS England confirmed that the 2016/17 BCF Plan had been approved on 15 August 2016, and that work is now being undertaken to ensure that the Section 75 agreement between the Council and the CCG is updated.

In considering the impact of these issues on our VFM conclusion, we have concluded that the Council has managed a difficult situation in relation to integration with health during 2015/16. Despite the challenges, the Council's contribution to BCF work streams in 2015/16 that were delivered within the financial envelope available is evidence that the Council had proper arrangements in place. As these pressures remain in 2016/17, this is likely to be an area we will seek to review again in next year's audit.

The 'Future Shape and Size' programme (FSS)

"Future Shape and Size" is the Council's over-arching transformation programme which aims to deliver an operating model which will realise significant financial savings whilst ensuring sustainable services into the long-term. The programme continues the ambition and themes of the previous Rewiring Public Services programme which was subject to a review of programme management arrangements in 2014/15 as part of our VFM conclusion work.

In line with our recommendations, the Council has taken the opportunity to clarify the direction of the programme, define priorities and streamline governance arrangements.

The refreshed programme has progressed well since its initiation having developed and evaluated concepts into emerging proposals for implementation. It has benefited from the significant amount of groundwork undertaken as part of the previous transformation programme of work.

Local Area Teams is the first major project under the programme umbrella at the implementation phase. This is the place-based operating model proposed for Children and Young People's prevention and early intervention services. We found good practice in terms of the project management and governance processes in place over this project, particularly in terms of the improved use of the Verto project management system. We concluded that the Council's arrangements are appropriate and effective for the management of this major change programme.

Overall conclusion

We satisfied ourselves that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016 and we issued an unqualified VFM conclusion.

04 Follow up of Public Interest Report recommendations

On 26 February 2016, we issued a Public Interest Report on governance issues in relation to remuneration of Council officers for work as Directors of City of York Trading Ltd. As part of the 2015/16 audit, we have followed up the implementation of our recommendations.

We asked officers to provide us with an update on progress made to date. In the table below, we include our original recommendations, the update provided by officers and our own comments on the progress to date.

Recommendations	Progress report from officers	Our comments on progress
R1 The Council should take steps to rectify the omission of Council approval for the payments made to the two directors of City of York Trading Ltd in March 2015 for work for the company in 2013/14.	The two directors have voluntarily repaid the payments made to them. No further action required.	Agree no further action is needed.
R2 Where the Council envisages a role for a committee within a Council-owned trading company to fulfil a Council function, as appears to have been the case with the Shareholder Committee of City of York Trading Ltd, the Council should ensure that the Constitution is amended to reflect this role and that the composition of the Committee is consistent with the Council's decision making and governance arrangements.	The Council continues to review the governance of its companies, including consideration of opportunities presented by trading some of its activities through external trading companies. Following the recommendations from the paper which went to June's Executive, a further report was taken to September's Executive, which set out the proposals to create a governance structure to oversee the activity of its current and future external bodies in which the council has an interest.	We note the decision to establish a single member decision making committee to act as shareholder and oversee the business of all Council trading companies. When these arrangements take effect the Council's Constitution needs to be updated to reflect them.
R3 The Council should review its approach to the establishment and governance of Council-owned companies to ensure that it fully reflects good practice and the lessons from this report.		We note that a comprehensive review of all Council trading companies was reported to the Executive on 30 June 2016, and a further report was taken to the Executive on 29 September 2016 setting out a new governance structure.

Recommendations	Progress report from officers	Our comments on progress
<p>R4 In the light of the conclusions of the review recommended in R3, the Council should prepare specific guidance to members and officers on their involvement in Council-owned companies.</p>	<p>The Council continues to review the governance of its companies, including consideration of opportunities presented by trading some of its activities through external trading companies. Following the recommendations from the paper which went to June’s Executive, a further report was taken to September’s Executive, which set out the proposals to create a governance structure to oversee the activity of its current and future external bodies in which the Council has an interest.</p>	<p>The specific guidance to members and officers on their involvement in Council-owned companies still needs to be produced. As noted in the response to R5, the Council intends to address this when it has implemented the measures arising principally from its response to R2 and R3.</p> <p>We note that this is an important recommendation and needs to be given priority in the near future.</p>
<p>R5 The guidance recommended in R4 should address the conflict of interest risks likely to arise where members and officers hold both Council and Council-owned company roles (unpaid and paid) and set out clear advice on how these should be managed. The guidance should also specifically address how the conflict of interest risks should be managed where the Council officers involved hold one of the three Statutory Officer roles of Head of Paid Service, Chief Finance Officer and Monitoring Officer.</p>	<p>As previously advised, the recommendation will be addressed when drafting new guidance once R2/3/4 have been completed.</p>	<p>As noted above, the Council intends to address this when it has implemented the measures arising principally from its response to R2 and R3.</p> <p>We note that this is an important recommendation and needs to be given priority in the near future.</p>
<p>R6 The Council should review its arrangements for ensuring that internal legal advice is followed, and that any instances where such advice is not followed are identified.</p>	<p>As previously confirmed this will continue to be managed within the Council’s constitutional procedure and where legal advice is prescriptive it will be followed.</p>	<p>We note the Council’s response in relation to this recommendation and have no further comments.</p>

Recommendations	Progress report from officers	Our comments on progress
<p>R7 Where there are unusual or sensitive transactions such as the remuneration paid to Council officers for their work for a Council-owned trading company, particularly where they take place for the first time, the Council should bring the matter to the auditor's attention during the audit.</p>	<p>As previously confirmed this will be picked up as part of the Council's Statement of Account procedures and any issues discussed with External Audit.</p>	<p>These issues have been considered in the audit of the 2015/16 financial statements. As noted in the response to R8 below, Council officers no longer receive payments of this nature.</p>
<p>R8 Where senior Council officers receive remuneration for their work for a Council-owned trading company, the Council should recognise this as a related-party transaction and disclose it in the notes to the financial statements.</p>	<p>As previously advised Council Officers no longer receive payments of this nature.</p>	<p>As noted in the response, as Council officers no longer receive payments of this nature, there are no such transactions to disclose in the related parties note to the financial statements.</p>
<p>R9 The Council should update the officer register of interests form and guidance notes to require disclosure of the value of any remuneration received for an individual officer's role in a Council-owned trading company.</p>	<p>New procedures have been put in place to ensure that staff at grade 10 and above complete an annual register of interests' declaration. The form and guidance has been updated to reflect best practice in local government.</p>	<p>Officer disclosures have been reviewed as part of the audit of the 2015/16 financial statements and we have not identified any audit issues from our review.</p>
<p>R10 The Council should review its system for ensuring that all annual returns are received for the officer register of interests.</p>		<p>Officer disclosures have been reviewed as part of the audit of the 2015/16 financial statements and we have not identified any audit issues from our review.</p>

05 Future challenges

In common with many other local authorities, the Council faces continued pressure on its finances with reduced central government funding and a move to fully localised business rate income.

The Council has set its revenue budget for 2016/17, including a 3% council tax increase. The medium term financial plan estimates the savings required in the four years 2016/17 to 2019/20 as £23m, of which £6.5m has been reflected in the 2016/17 budget.

In the budget for the HRA a key factor in the next few years will be a requirement to reduce rents by 1% per annum. The Council has still been able to set a budget for 2016/17 for the HRA which predicts a £3.7m surplus.

The key challenges for the Council include:

- implementing the new management structure;
- making a reality of the key priorities in the Council Plan 2015 – 2019 and the new vision for 2030;
- delivering the demanding programme of projects that the Council has in place to improve the outcomes for the City and its residents;
- continuing to operate in an environment of austerity where further cuts in spending, new ways of working and alternative models of service delivery are likely to be required; and
- positioning the City of York to best advantage in the devolution process.

We will focus our 2016/17 audit on the risks that the challenges facing the Council present to your financial statements and your arrangements for securing value for money.

A major technical change in 2016/17 is the need to account for highways infrastructure on a depreciated replacement cost basis as required by the local government accounting code. This will require significant changes in the 2016/17 statements and we are already working with officers to ensure the required systems are in place.

Another key focus in the coming year will be on working with officers to bring forward the accounts and audit timetable in advance of the change in the statutory deadline which will take effect from the 2017/18 financial year.

06 Fees

As outlined in our Audit Strategy Memorandum presented to the Audit and Governance Committee on 13 April 2016, Public Sector Audit Appointments Ltd (PSAA) sets a scale fee for our audit work. The fees applicable to our work in 2015/16 are summarised below.

Element of work	2014/15 Final Fee	2015/16 As previously reported	2015/16 Final Fee
Code audit work ¹	183,476 ²	126,607 ³	124,294 ³
Certification work	15,220	11,679	11,679 ⁴
Non-audit work	21,900	0	2,750 ⁵
Estimated fee in relation to the 2015/16 Objection	0	0	7,500 ⁶
Total	220,596	138,286	146,223

All fees are shown excluding VAT

¹ The main reason for the reduction in the scale fee for Code audit work between 2014/15 and 2015/16, is that Public Sector Audit Appointments Ltd has passed on the 25% fee reduction arising from the final procurement exercise undertaken by the Audit Commission before its closure in March 2015. The value of this reduction to the Council was £33,869. The rest of the difference was explained by additional work that was undertaken in the 2014/15 audit as set out in ² below.

² The final fee for 2014/15 included an initial scale fee of £135,476, plus an additional £8,500 to reflect additional VFM conclusion work in relation to programme and project management. In addition, the final fee included the additional cost of work in relation to our public interest report on City of York Trading Limited. The cost of this work was £27,000 in audit fees and £12,500 reimbursement of our legal costs, a total of £39,500.

³ The proposed fee for the 2015/16 audit was £25,000 higher than the scale fee of £101,607. The £25,000 was the estimated cost of the additional VFM conclusion work which we described in section 3 of this report. In the event, our charge for this additional work was £22,687, slightly below our estimate. This work and the fee for it was approved by our regulator, Public Sector Audit Appointments Ltd.

⁴ The fee outlined in relation to certification work is an estimate as we are yet to complete our work on certifying the Council's Housing Benefit claim.

⁵ For 2015/16, the only non-audit work related to the 2015/16 teachers' pensions return at a fee of £2,750.

⁶ We estimate that the cost of additional work in relation to the objection in the 2015/16 audit will be in the region of £7,500. At the time of writing this report this work is not yet completed and we cannot clarify the exact fee that will be charged. Any fee we determine will require the approval of our regulator, Public Sector Audit Appointments Ltd. When agreed, it is expected that these fees will be part of Code audit work for 2015/16.

Should you require any further information on this letter or on any other aspects of our work, please contact:

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